



A8825-1

Vol. XI, No. 4

June 28, 1985

The 1984 Performance of the Securities Industry by Firm Category

Highlights

1. In 1984, profitability dropped for all firm categories. Only two categories were profitable while the others were either marginally profitable or actually unprofitable. The after-tax ROEs were: Large Investment Banks (LIB), 17%; New York City Regionals (NYC), 11%; and Regionals Based Outside N.Y. (REG), 4%. National Full-Line (NFL) and Discounters (DIS) had losses with a pre-tax ROE of (2)% each.
2. LIB was the most profitable firm category in 1984 because of the emphasis on principal business in debt securities and institutional customers. REG, NFL and DIS suffered last year being more dependent on dealing with retail clients.
3. NYSE and NASD DIS firms' market share of retail commissions and retail share volume rose in 1984. Their estimated market share of retail commissions increased in 1984 to 9.6% from 8.5% in 1983. Their estimated market share of retail share volume rose last year to 19.2% compared to 17.0% in 1983.
4. DIS firms' market share of total revenues declined slightly to 1.2% in 1984 because of their emphasis on agency business - - commissions and margin interest. This may help explain why DIS firms are seeking to add new products and services.
5. Industry profitability rose in the 1Q 1985 largely because of increased activity in the equity business. Annualized after-tax ROE was 16% in the 1Q 1985 compared with 7% in 1984. Factors are in place for ROE to rise appreciably in 1985 as interest rates have fallen and cost containment programs have been instituted at securities firms.

Introduction

Five years of high profitability in the securities industry came to an abrupt halt in 1984. All firm categories suffered a significant decrease in profitability. This issue of Trends examines the 1984 performance of the securities industry by firm category, including revenues, expenses and profitability. The firm categories analyzed are National Full-Line (NFL), Large Investment Banks (LIB), New York City Based Regionals (NYC), Regionals Based Outside of N.Y. (REG) and Discounters (DIS).

Profitability

In 1984, the securities industry's after-tax ROE dropped to 7%, the lowest level since 1977.^{1/} The industry had enjoyed five previous years of unprecedented profitability, with after-tax ROE averaging 21% from 1979 to 1983. Thus, the 1984 results reflected a discouraging reversal in the fortunes of the securities industry.

Profitability dropped in 1984 for all firm categories. The ROE for some categories plunged to levels not experienced since 1974, or since comparable data by firm categories were tabulated.

Despite robust economic growth in 1984, only a couple of firm categories were profitable. Others were marginally profitable or actually unprofitable. This paper will cover the decreases and divergencies in the profitability performances among firm categories during a year when the economy expanded at its most rapid rate since 1951.

LIB was the most profitable firm category in 1984, with an after-tax ROE of 17% (Table 1). NYC Regionals had the second highest after-tax ROE, 11%. REG was marginally profitable while the NFL and DIS sustained actual losses. The dispersion in ROEs among the categories widened last year. In 1983, the after-tax ROEs ranged from 15% to 27%, with a median of 24%. In 1984, the after-tax ROEs ranged from about (2)% to 17%, with a 4% median.^{2/}

^{1/} The 1984 profitability performance of the securities industry was analyzed in "The 1984 Performance of the Securities Industry," Trends, April, 1985.

^{2/} The NFL and DIS categories each had a 1984 pre-tax ROE of (2)% which is compared to the after-tax ROEs of the other categories.

Table 1
After-Tax Return-on-Equity

<u>Firm Categories</u>	<u>1983</u>	<u>1984</u>	<u>Change in Percentage Points, 1983-1984</u>
National Full-Line	15.2%	(2.4)% ^{1/}	(17.6)
Large Investment Banks	23.7	16.8	(6.9)
N.Y.C. Based Regional	27.3	10.8	(16.5)
Regional	21.9	3.7	(18.2)
Discounter ^{2/}	<u>22.7</u>	<u>(2.4)</u> ^{1/}	<u>(25.1)</u>
Industry ^{3/}	19.8%	7.2%	(12.6)

^{1/}Pre-tax ROE

^{2/}NYSE and NASD Discounters

^{3/}For NYSE firms doing a public business.

() Negative

Source: Securities Industry Database

Component analysis provides insight about why the ROE for each of the various firm categories declined in 1984 (Table 2). NFL firms suffered a loss, as shown by the negative profit margin. Their asset turnover dropped significantly, while the leverage ratio for these firms rose substantially. The LIB category was the most profitable last year and had both the highest profit margin and leverage ratio. As always, asset turnover was the lowest of the firm categories.

The NYC firms' profit margin dropped even more than the NFL's; however, their asset turnover decreased less than that of all other categories except LIB and their leverage ratio rose modestly. The REG firms' profit margin and asset turnover ratio fell more than all other categories except for the DIS firms which suffered the sharpest declines in these ratios and were unprofitable as a group.

Table 2
Component Analysis of After-Tax Return on Equity

<u>Firm Categories</u>		<u>Profit</u> <u>Margin</u> (<u>\$</u>)	x	<u>Asset</u> <u>Turnover</u> (<u>\$</u>)	x	<u>Leverage</u> x	<u>Tax</u> <u>Retention</u> <u>Rate</u> (<u>%</u>)	=	<u>ROE</u> (<u>%</u>)
Nat'l Full Line	1982	.0881		.2681		12.6	54.0%		16.1%
	1983	.0858		.2400		13.7	54.0		15.2
	1984	(.0083)		.1787		16.0	-		(2.4) ^{1/}
Lg. Invst. Bks.	1982	.1736		.1045		30.2	54.0		29.6
	1983	.1673		.0872		30.0	54.0		23.7
	1984	.1144		.0837		32.5	54.0		16.8
New York Based	1982	.1403		.2257		13.7	54.0		23.4
	1983	.1834		.2267		12.2	54.0		27.3
	1984	.0886		.1779		12.7	54.0		10.8
Regional	1982	.1108		.3439		9.4	54.0		19.4
	1983	.1265		.4083		7.8	54.0		21.9
	1984	.0259		.3235		8.1	54.0		3.7
Discounter ^{2/}	1982	.1360		.4932		7.30	54.0		26.4
	1983	.1396		.5005		6.69	54.0		25.2
	1984	.0034		.3873		6.48	54.0		0.5
Industry	1982	.1308		.1787		17.3	54.0		21.9
	1983	.1294		.1631		17.3	54.0		19.8
	1984	.0515		.1348		19.1	54.0		7.2

^{1/}Pre-tax ROE

^{2/}NYSE Discounters

() Negative

Firm Categories

In 1984, profitability was highest for the firm category most dependent on principal business and institutional customers, LIB, and significantly lower or unprofitable for the other firm categories more dependent on dealing with retail clients.

National Full-Line

The NFL firm category sustained a pre-tax loss of \$118 million. Pre-tax ROE for this category was (2)%. Data on the NFL firm category are available from SIA starting with 1973. Last year marked the first time that an actual loss occurred. Total revenues rose only 1% while expenses climbed nearly 12% (Table 3). Proximate non-interest revenues (excludes margin interest and other-related revenues) fell 6% and non-interest expenses decreased 3%.^{3/} The NFL category's loss resulted because of a downturn in the agency business and the inability to cut costs enough to compensate for lower revenues. With interest expense rising 61%, generating sufficient revenues to offset such pressure was a formidable task.

Revenues

Proximate non-interest revenues dropped mainly because of the lack of retail customer interest in equities, which resulted from the uncertain economic environment and high real interest rates available on alternative investments. Five of the nine non-interest revenue sources decreased by almost \$1.2 billion last year. More than 90% of this fall resulted from the drop in equity related revenue sources. Commissions were responsible for 46% of this drop; market making OTC, 17%; mutual funds, 15%; and underwriting, entirely because of the plunge in equity underwriting, accounted for 9%. Revenues from the four other non-interest sources grew by \$500 million, but most of this increase was not related to equity business. Other-unrelated revenues were responsible for almost 50% of this increase; trading profits, solely because of the activity in debt securities, generated another 29%; investment profits, 15%; and account supervision, 7%.

The 19% fall in commissions for NFL firms was steeper than the industry's 15% drop. This occurred because of the retail orientation and customer base of NFL firms. LIB firms are institutionally directed and NYC firms have a heterogeneous

^{3/} A comparison of proximate non-interest revenues and non-interest expenses helps to better understand the reasons for the change in profitability by minimizing the effects of interest rate trends on revenues and expenses.

Table 3
National Full-Line Firms
Revenues and Expenses, 1983 and 1984^{1/}
(millions of dollars)

	1983	1984	Change, 1983-1984	
			Dollars	Percent
REVENUES				
Commissions	\$3,629	\$2,936	\$(693)	(19)%
Listed equities on an exchange	2,656	2,163	(493)	(19)
Listed equities, OTC	42	30	(13)	(30)
Options	487	478	(9)	(2)
All Other	443	265	(178)	(40)
Trading Profits	2,892	3,038	146	5
Market Making - OTC equity	780	526	(254)	(33)
Debt Securities	1,991	2,338	347	17
Options on Nat'l Exchange	02/ ^{2/}	3	3	1,400
All Other	121	170	49	41
Investment Profits	37	110	73	200
Underwriting	1,593	1,457	(136)	(9)
Equity	277	57	(220)	(79)
Debt	1,316	1,400	84	6
Margin Interest	1,201	1,547	346	29
Mutual Fund Sales	777	550	(228)	(29)
Account Supervision	250	285	36	14
Research	2	(1)	(3)	(157)
Commodities	703	608	(95)	(14)
Other-Related	1,525	1,979	455	30
Other-Unrelated	316	560	244	77
TOTAL REVENUES	\$12,923	\$13,066	\$143	1%
EXPENSES				
Employment	\$6,078	\$5,976	\$(102)	(2)%
RR Compensation	3,451	3,246	(205)	(6)
Clerical & Administrative	2,627	2,730	103	4
Floor Brokerage & Clearance	362	347	(15)	(4)
Fixed Expenses	1,701	2,124	422	25
Communications	923	1,066	143	15
Occupancy & Equipment	630	861	231	37
EDP Equipment	148	197	49	33
Promotional Costs	468	459	(9)	(2)
Interest Expense	1,757	2,822	1,065	61
Errors and Bad Debt	153	145	(8)	(6)
Non-recurring Charges	94	10	(84)	(89)
Partners & Stockholders	177	191	13	8
Regulatory Fees and Expenses	46	49	3	6
Other Expenses	980	1,063	85	9
TOTAL EXPENSES	\$11,814	\$13,184	\$1,371	12%
PRE-TAX NET INCOME	\$1,109	\$(118)	\$(1,227)	(111)%

^{1/} Discrepancies may exist due to rounding.

^{2/} Less than \$500,000.

() Negative

Source: Securities Industry Database

clientele as some of the larger firms focus on money management and institutional business. In 1984, the industry's retail commissions were estimated to have plunged 26%, but institutional commissions fell by less than 8%.^{4/} NFL commissions also decreased more than REG (16%) and DIS (12%).

NFL was one of only two firm categories to experience an increase in trading profits last year. However, trading profits for NFL firms increased a modest 5%, the smallest gain since 1977. From 1977 to 1983, their compound annual growth rate for trading profits was 33%. Trading profits as a proportion of NFL total revenues rose from 15% in 1977 to 23% in 1984. Debt securities were responsible for 87% of the 1984 increase in trading profits. On the other hand, trading profits from OTC market making plunged 33% from 1983.

Underwriting revenues for NFL firms decreased significantly less, 9%, than for the industry, 24%. This comparatively better performance resulted partly because of Shearson/American Express' 1984 acquisition of Lehman Brothers and the large share of the record volume of long-term municipal underwriting garnered by NFL firms. Shearson's corporate underwriting ranking rose from twelfth in 1983 to sixth in 1984, and its municipal underwriting ranking rose from seventh in 1983 to fourth in 1984.^{5/} The NFL firm category was the only category to experience an increase in debt underwriting revenues. NFL firms' 1984 proportion of the record volume of long-term municipal underwriting was 36%, slightly greater than the 34% in 1983.

Other-related revenues rose by 30%, significantly greater than total revenues which increased only 1%. Since 1979, other-related revenues have increased for NFL firms at a compound annual growth rate of 38%. As a result, their

^{4/} Retail commissions are estimated to have fallen from \$3.3 billion in 1983 to \$2.5 billion in 1984, a 26% drop. Institutional commissions are estimated to have declined from \$5.0 billion in 1983 to \$4.6 billion in 1984, an 8% decrease. For data on total commissions and estimated percentages of retail and institutional commissions see SIA, Trends, April 1985, pages 8 and 10.

^{5/} Sources: Institutional Investor and Public Securities Association.

proportion of NFL total revenues has risen from 4% in 1977 to 15% in 1984. Interest on the repo business is believed to be the largest component of this revenue line. The average amount of reverse repos for NFL firms rose from \$13.6 billion in 1983 to \$24.7 billion in 1984.

Expenses

The increase in NFL firms' expenses slowed significantly in 1984 because of decreases in certain expenditure items as business activity fell and management employed efforts to limit costs. However, this slowdown in expense growth was not sufficient to prevent a loss from occurring as total revenues rose minimally from 1983. NFL firms have high fixed costs related to their branch office system. In addition, prior commitments to expand branch office systems and to improve equipment for competitive reasons were continued.

Total expenses rose by 12% in 1984, the smallest increase since 1977. NFL firms' total expenses had increased at a compound annual growth rate of 28% from 1977 to 1983. Interest expense climbed 60%, representing almost 70% of the total 1984 rise in expenses. Non-interest expenses increased only 3%.

Employment expenses decreased 2% because of a 6% fall in RR compensation due to declining production. Nevertheless, the average number of RRs and some other income producing employees continued increasing last year, to 46,600 from 42,600 in 1983. Clerical and administrative employee expenses rose 4%, as the average number of these employees also increased, to 75,900 from 69,960 in 1983. However, non-income producing employment declined during the last half of 1984.

So-called fixed expenses continued to climb for NFL firms despite the lagging business. Last year, total fixed expenses rose by 25%. From 1977 to 1983, so-called fixed expenses for NFL firms increased at a compound annual growth rate of 24%. Occupancy and equipment rose 37% last year. EDP equipment costs climbed 33% due in part to the growth in mini-computers for departmental systems and the switch from leasing to the purchase of equipment for tax purposes. Communications expenses rose 15% given the need for better quality equipment and increased usage of communication lines.

Large Investment Banks

LIB, with an after-tax ROE of 17%, was the most profitable firm category in 1984. Since 1974, relative to ROE, LIB was the highest ranked firm category for nine years and second highest in one year.^{6/} In analyzing the LIB's 1984 performance, it should be noted that there were only ten firms in this category in the last-half of the year compared with eleven firms in 1983.^{7/}

LIB's 1984 after-tax ROE dropped considerably from the 1983 level of 24%. Total revenues rose 23% and total expenses climbed 31%, mostly because of higher average interest expense (Table 4). Proximate non-interest revenues grew 7% last year compared with 28% in 1983, while non-interest expenses increased 4% compared with 38% in 1983. Nevertheless, LIB was the only firm category to enjoy an increase in proximate non-interest revenues last year.

Revenues

In 1984, LIB fared better than the other firm categories mainly because of differences in business mix. LIB is significantly more dependent on principal business than the rest of the industry. For example, trading profits accounted for 34% of LIB's total revenues last year, compared with 20% for the rest of the industry. Within trading profits, LIB emphasizes debt securities more than, and OTC market making less than, other firm categories.

In 1984, firms earned significant trading profits on debt securities as long-term interest rates fell during the last-half of the year. As a result, LIB's trading profits climbed a reported 25%, with debt securities soaring by a reported 34%. In contrast, their trading profits from OTC market making plunged by 50%.

LIB also relies heavily on other-related revenues. Last year, other-related revenues accounted for 33% of LIB's total revenues, compared with 14% for the rest of the industry.

^{6/} DIS's ROE is included in this comparison only since 1982 when SIA began tracking and reporting publicly on this firm category.

^{7/} Increases in LIB revenues and expenses in 1984 would have been somewhat greater than those reported and decreases would have been slightly smaller if 1983 data had been adjusted for the same number of firms as in 1984.

Table 4
Large Investment Banks
Revenues and Expenses, 1983 and 1984^{1/}
(millions of dollars)

	1983	1984	Change, 1983-1984	
			Dollars	Percent
REVENUES				
Commissions	\$1,216	\$1,068	\$(148)	(12)%
Listed equities on an exchange	1,049	915	(134)	(13)
Listed equities, OTC	19	2	(16)	(89)
Options	67	70	3	5
All Other	82	81	(1)	(2)
Trading Profits	2,708	3,397	698	25
Market Making - OTC equity	244	119	(125)	(51)
Debt Securities	2,013	2,702	688	34
Options on Nat'l Exchange	42	(3)	45	(107)
All Other	409	580	171	42
Investment Profits	365	364	(1)	(0) ^{2/}
Underwriting	1,051	734	(317)	(30)
Equity	230	98	(133)	(58)
Debt	821	636	(184)	(22)
Margin Interest	269	385	116	43
Mutual Fund Sales	10	11	1	14
Account Supervision	85	111	27	32
Research	0 ^{3/}	0 ^{3/}	0	0
Commodities	62	65	3	4
Other-Related	1,984	3,327	1,342	68
Other-Unrelated	458	640	181	35
TOTAL REVENUES	\$8,209	\$10,103	\$1,894	23%
EXPENSES				
Employment	\$1,904	\$1,926	\$22	1%
RR Compensation	857	786	(71)	(8)
Clerical & Administrative	1,048	1,140	92	9
Floor Brokerage & Clearance	203	216	13	6
Fixed Expenses	505	605	100	20
Communications	231	261	30	13
Occupancy & Equipment	206	259	53	26
EDP Equipment	68	85	17	25
Promotional Costs	110	140	30	27
Interest Expense	3,358	5,318	1,960	58
Errors and Bad Debt	29	21	(8)	(3)
Non-recurring Charges	0	0 ^{3/}	0 ^{3/}	0 ^{2/}
Partners & Stockholders	289	301	12	4
Regulatory Fees and Expenses	23	28	5	24
Other Expenses	415	394	(22)	(5)
TOTAL EXPENSES	\$6,836	\$8,948	\$2,112	31%
PRE-TAX NET INCOME	\$1,373	\$1,155	\$(218)	(19)%

1/ Discrepancies may exist due to rounding

2/ Percent change was less than 0.5%.

3/ Less than \$500,000.

() Negative

Source: Securities Industry Database

Interest on the repo business is the largest proportion of these revenues. However, merger and acquisition fees and private placement fees are also included. In 1984, M&A activity and private placements reached record levels.^{8/}

LIB depends on commissions and other equity related revenue sources much less than the rest of the industry. In 1984, commissions accounted for 11% of LIB total revenues compared to 29% for the rest of the industry. In addition, LIB generates institutional commissions which decreased much less last year than retail commissions.

LIB experienced a reported 30% drop in underwriting revenues, significantly greater than the rest of the industry's 21% decrease. Revenue from equity underwriting plunged nearly 60% compared with 1983, while revenue from debt underwriting decreased 20%.^{9/}

Expenses

Total expenses escalated more for LIB (31%) than the rest of the industry (15%) largely because of a 60% increase in interest expense. The jump in interest expense accounted for more than 90% of the climb in LIB total expenses.

So-called fixed expenses rose a reported 20% and were responsible for 55% of the increase in non-interest expenses. Since 1977, fixed expenses have increased at a compound annual growth rate of about 19%. Occupancy and equipment and EDP equipment costs had the largest increases, followed by communications.

Regional

REG firms' after-tax ROE dropped to 4% in 1984 from 22% in 1983, representing the sharpest drop in profitability among the categories except for DIS. This decrease in ROE occurred principally because of REG's relatively greater dependence on commissions and underwriting revenues, both of which fell

^{8/} Source for M&A activity is W.T. Grimm and for private placements, Dealers' Digest.

^{9/} This drop in total underwriting revenues would not have been as sharp if these revenues were adjusted for the acquisition of Lehman Brothers.

mostly because of the weak equity market (Table 5). The REG category suffered the largest decline in both total revenues (11%) and proximate non-interest revenues (18%) among the categories while total expenses remained at the 1983 level and non-interest expenses fell 5%.

Revenues

The falloff in underwriting revenues and commissions accounted for more than 95% of the plunge in proximate non-interest revenues. Underwriting revenues plunged \$235 million, while commissions dropped \$231 million. The absolute fall in underwriting revenues was almost evenly distributed between decreases in equity underwriting revenue (\$115 million) and debt underwriting revenue (\$120 million).

Although REG's percentage decrease in equity underwriting revenue was in-line with that of the total industry, the drop in debt underwriting revenue was sharper. Debt underwriting revenue declined despite the record volume in municipal underwritings. The increase in Rule 415 debt offerings explains part of the falloff. Rule 415 debt offerings accounted for 56% of corporate debt offerings in 1984. These underwritings are often the product of the more heavily capitalized firms who manage the distribution without forming a syndicate. As a result, REG firms are often excluded from such deals. Underwriting revenues also fell because of the plunge in equity volume. From 1979 to 1983, underwriting revenues as a proportion of REG's total revenues rose steadily from 9% to 17%; however, this proportion dropped to 12% in 1984.

Trading profits increased consistently as a proportion of REG's total revenues from 1979 to 1983. However, in 1984 they accounted for the same proportion of total revenues, 16%, as in 1983. Much of REG's trading activity is directed to OTC market making and the adverse conditions in the 1984 OTC market translated to diminished profits for REG firms.

Expenses

Cost controls were implemented by REG firms in 1984 as total expenses were held in-line with 1983, despite a 44% increase in interest expense. Non-interest expenses actually decreased by 5%.

Employment expenses fell by 12%. RR compensation dropped 18% given lower production, and clerical and administrative employee expenses declined by 0.5%. Average employment of RRs and other income producing employees rose 7% to 15,466, and non-income producing employment increased 4% to 20,716.

REG's fixed expenses increased only 13%, significantly less than all other categories and the industry's 22% climb. In addition, the 1984 rise represented a significant slowdown from the 21% growth in fixed expenses in 1983.

Table 5
Regional Firms
Revenues and Expenses, 1983 and 1984^{1/}
(millions of dollars)

	1983	1984	Change, 1983-1984	
			Dollars	Percent
<u>REVENUES</u>				
Commissions	\$1,406	\$1,176	\$(231)	(16)%
Listed equities on an exchange	877	729	(148)	(17)
Listed equities, OTC	28	12	(16)	(59)
Options	113	129	16	14
All Other	388	306	(82)	(21)
Trading Profits	596	530	(65)	(11)
Market Making - OTC equity	254	174	(81)	(32)
Debt Securities	260	296	36	14
Options on Nat'l Exchange	4	1	(3)	(85)
All Other	82	63	(19)	(24)
Investment Profits	34	17	(17)	(50)
Underwriting	631	396	(234)	(37)
Equity	185	71	(115)	(62)
Debt	445	325	(120)	(27)
Margin Interest	304	400	96	32
Mutual Fund Sales	138	161	23	17
Account Supervision	46	44	(3)	(6)
Research	11	6	(44)	(41)
Commodities	43	41	(2)	(4)
Other-Related	340	410	71	21
Other-Unrelated	73	58	(14)	(20)
<u>TOTAL REVENUES</u>	<u>\$3,621</u>	<u>\$3,240</u>	<u>(381)</u>	<u>(11)</u>
<u>EXPENSES</u>				
Employment	\$1,652	\$1,452	\$(190)	(12)%
RR Compensation	1,034	847	(187)	(18)
Clerical & Administrative	608	605	13	(1)
Floor Brokerage & Clearance	174	166	(8)	(4)
Fixed Expenses	453	512	61	13
Communications	236	262	26	11
Occupancy & Equipment	167	197	29	18
EDP Equipment	50	55	5	10
Promotional Costs	97	98	1	1
Interest Expense	295	424	129	44
Errors and Bad Debt	28	23	(5)	(16)
Non-recurring Charges	2	12	10	485
Partners & Stockholders	258	221	(36)	(16)
Regulatory Fees and Expenses	27	29	2	6
Other Expenses	187	215	28	15
<u>TOTAL EXPENSES</u>	<u>\$3,163</u>	<u>\$3,155</u>	<u>\$(7)</u>	<u>(0.2)%</u>
 PRE-TAX NET INCOME	 \$457	 \$84	 \$(373)	 (82)%

^{1/} Discrepancies may exist due to rounding.
Source: Securities Industry Database

New York City Regionals

NYC firms' 11% after-tax ROE was the second highest among firm categories in 1984, albeit significantly lower than the 23% of 1983. Since 1974, NYC Regionals have been the second most profitable category. These firms maintained reasonable profitability in 1984 because of a comparatively modest increase in expenses given the small decrease in revenues. Although total revenues declined by 3%, expenses rose by only 8% (Table 6). Interest accounted for nearly 50% of the rise in total expenses. Proximate non-interest revenues fell 9%, and non-interest expenses increased by less than 3%.

Revenues

Proximate non-interest revenues were reduced in 1984 by lower commissions, trading profits and underwriting. However, the drop in revenues was limited by the climb in fees for account supervision and other-unrelated revenues.

Only DIS rely on commissions for a higher proportion of their revenues than NYC. Commissions last year accounted for 36% of NYC total revenues, compared with 22% for the rest of the industry. NYC commissions fell 14% in 1984, thus representing almost 50% of the drop in proximate non-interest revenues. "Other" commissions suffered a steeper fall in revenue (\$64 million) than listed equities executed on an exchange (\$59 million). Included in "other" are commissions earned on OTC option transactions, agency business in OTC stocks and debt transactions. Commissions on listed equities executed on an exchange declined only 10% last year, the smallest decrease among firm categories.

Trading profits are a less important revenue source for NYC firms than the rest of the industry. For example, last year they accounted for 12% of this category's total revenues compared with 25% for the rest of the industry. Trading profits for NYC firms fell 20% in 1984, causing proximate non-interest revenues to drop by nearly 25% from the 1983 level. The fall in NYC firms' trading profits contrasts with the industry's 11% increase. Losses in OTC market making as well as "other" contributed to the drop in trading profits.^{10/} In addition, trading profits on debt securities rose only 8% compared with the industry's 25% climb.

^{10/} "Other" trading profits include market making on exchange listed equities executed on an exchange, unlisted options and market value of proprietary securities deposits with clearing organizations.

Table 6

New York City Regionals
Revenues & Expenses, 1983 and 1984^{1/}

	1983	1984	Change, 1983-1984	
			Dollars	Percent
REVENUES				
Commissions	794	681	(114)	(14)%
Listed Equities, on an exchange	567	508	(59)	(10)
Listed Equities, OTC	12	18	6	52
Options	44	47	3	6
All Other	172	108	(64)	(59)
Trading Profits	259	206	(53)	(21)
Market Making - OTC Equities	73	32	(42)	(57)
Debt Securities	105	113	9	8
Options on Nat'l Exchange	9	19	10	110
All Other	74	42	(32)	(43)
Investment Profits	73	63	(10)	(14)
Underwriting	87	34	(53)	(61)
Equity	38	11	(27)	(72)
Debt	49	23	(26)	(52)
Margin Interest	175	230	56	32
Mutual Fund Sales	11	9	(3)	(25)
Account Supervision	68	115	47	69
Research	4	3	(1)	(36)
Commodities	13	17	5	39
Other-Related	222	241	19	9
Other-Unrelated	48	107	60	125
TOTAL REVENUES	\$1,754	\$1,705	\$(49)	(3)%
EXPENSES				
Employment	\$606	\$586	\$(20)	(3)%
RR Compensation	307	264	(45)	(15)
Clerical & Administrative	299	322	23	8
Floor Brokerage & Clearance	141	140	(1)	(1)
Fixed Expenses	166	201	35	21
Communications	74	86	12	17
Occupancy & Equipment	65	86	21	32
EDP Equipment	27	27	0 ^{2/}	0 ^{3/}
Promotional Costs	29	35	6	20
Interest Expenses	258	347	89	35
Errors and Bad Debts	7	9	3	36
Non-recurring Charges	0 ^{2/}	4	3	800
Partners & Stockbrokers	97	84	(12)	(13)
Regulatory Fees and Expenses	18	13	(4)	(25)
Other Expenses	112	137	25	23
TOTAL EXPENSES	\$1,433	\$1,554	\$121	8%
PRE-TAX NET INCOME	\$321	\$151	\$(170)	(53)%

^{1/} Discrepancies may exist due to rounding
^{2/} Less than \$500,000.
^{3/} Less than 0.5%.

Source: Securities Industry Database

NYC Regionals also depend less on underwriting revenues than the other categories except for DIS firms. Last year, only 2% of NYC revenues were generated from underwriting, compared with 8% for the rest of the industry. Underwriting revenues plunged 60% in 1984 for the NYC category, compared to a 24% drop for the industry. NYC Regionals sustained a greater falloff because of their comparatively greater involvement in equity underwriting.

However, the diversification of NYC firms' revenues limited the drop in proximate non-interest revenues. Fees for account supervision are a much more important revenue source for NYC firms than the other categories and they rose by nearly 70% last year. In addition, revenues unrelated to securities climbed by 125%. In 1984, revenues from these two sources rose by \$106 million and partially offset the \$235 million drop in other areas.

Expenses

NYC firms had the second smallest change, a 3% increase, in non-interest expenses in 1984 among the firm categories. REG firms' non-interest expenses decreased 5%. Decreases in employment expenses and partners and stockholder costs dampened the rise of non-interest expenses. However, comparatively large increases were experienced for so-called fixed expenses and other expenses.

Employment expenses decreased 3% based on a 15% drop in RR compensation. The NYC firms' RR compensation fell more than the other categories except for REG firms because of the plunge in underwriting revenues.

So-called fixed expenses rose 20% for NYC firms in 1984, about the same increase as in 1983 when profitability was much higher. In 1984, occupancy and equipment climbed the fastest followed by communications. EDP equipment costs actually declined.

Discounters

SIA began analyzing the performance of discounters in 1982 because of widespread interest in this segment of the industry. Included in our analysis are DIS firms which are members of both the NYSE and NASD. NASD DIS firms account for more than 20% of total DIS commissions and revenues (Table 7). Revenues, expenses and income for NYSE members and sole NASD members must be aggregated to examine the DIS category's market shares of retail commissions and total revenues (Table 8).

Table 7

NYSE and NASD Discounters
Revenues, Expenses and Income, 1984
(millions of dollars)

	<u>NYSE</u>	<u>NASD</u>	<u>Industry</u>
Revenues	\$356.4	\$102.7	\$459.1
Commissions	232.3	64.8	297.1
Expenses	355.3	107.8	463.1
Pre-tax Net Income	1.2	(5.3)	(4.1)

Table 8

Industry Revenues, Expenses and Income, 1984
(millions of dollars)

	<u>NYSE</u>	<u>NASD</u>	<u>Industry</u>
Revenues	\$31,216.0	\$6,126.8	\$37,342.8
Commissions	7,094.6	1,769.6	8,864.2
Expenses	29,608.2	5,601.2	35,209.4
Pre-tax Net Income	1,607.8	525.6	2,133.4

The DIS category suffered a loss in 1984 because of retail customers' diminished interest in equities. Of all the firm categories, this group is the most dependent on agency business and the least diversified. For example, during the past three years, commissions and margin interest revenue accounted for 86% of the DIS category's total revenues compared with 35% for the rest of the industry. Commissions produced 68% of DIS firms' total revenues contrasted to 26% for the rest of the industry. Margin interest revenue amounted to 17% of this category's total revenues as opposed to 9% for the rest of the industry.^{11/}

^{11/} Estimates based upon NYSE discounters only.

The DIS category suffered a pre-tax loss of \$4 million in 1984 when its pre-tax ROE was (2)%, compared with an after-tax ROE of 22% in 1983. Revenues declined 2% as commissions dropped 12%. Expenses rose by 12% because of the climb in interest as well as so-called fixed expenses. Interest expense climbed nearly 70%, accounting for 40% of the rise in total expenses.^{12/} So-called fixed expenses increased nearly 45%, representing almost 35% of the rise in total expenses.

NYSE and NASD DIS firms' market share of retail commissions and retail share volume rose in 1984 as their retail commission business apparently fell less than the rest of the industry. The DIS category's retail commissions decreased 12% compared with the rest of the industry's 24% fall. As a result, their estimated market share of retail commissions increased in 1984 to 9.6% from 8.5% in 1983 (Table 9). Their estimated market share of retail share volume rose last year to 19.2% compared to 17.0% in 1983.^{13/}

The DIS category's larger 1984 market share occurred partly because of increased promotional activity. Promotional costs for DIS firms climbed 19% compared with less than 5% for the rest of the industry. Among the categories, NFL and REG promotional expenses remained essentially at their 1983 levels. In addition, customers of DIS firms appear to be more active traders. Nevertheless, DIS firms' market share of total revenues declined slightly to 1.2% in 1984 because of the lack of diversification. This may help explain why DIS firms are seeking to add products and services.

^{12/} Interest expenses and so-called fixed expenses were estimated based upon NYSE DIS data.

^{13/} Estimated based on assumption that discounters' commission rates are about one-half that of full-service firms'.

Table 9

NYSE and NASD Discounters' Market Share, 1982 to 1984 1/
(millions of dollars)

	<u>1982</u>	<u>1983</u>	<u>1984</u>
Industry Commissions	\$6,956.6	\$9,992.0	\$8,865.0
Estimated Retail Commissions	3,394.8	3,996.8	3,085.0
Discounters' Commissions	224.3	338.4	297.1
Discounters' Market Share of Retail Commissions	6.6%	8.5%	9.6%
Industry Gross Revenues	\$26,865.3	\$34,887.1	\$37,344.9
Discounters' Gross Revenues	338.6	466.1	459.1
Discounters' Market Share of Gross Revenues	1.3%	1.3%	1.2%

1/ Revised 1982 and 1983 data.

First-Quarter 1985

Industry profitability rose in the 1Q 1985 to its highest quarterly level since the 2Q 1983. Annualized after-tax ROE was almost 16%. In addition, 83% of NYSE member firms were profitable, a significant improvement from the 65% in 1984. Compared with 1984, annualized total revenues increased 15% while total expenses rose less than 9%.

The increased interest in equities was responsible for more than 60% of the rise in proximate non-interest revenues. The attraction of equities improved because of the drop in interest rates. As a result of the renewed interest in equities, there were significant increases in commissions, trading profits from market making OTC, equity underwriting, net margin interest income and mutual fund sales. In the following analysis of the industry's 1Q 1985 performance, all 1Q 1985 data are compared with 1984 average quarterly data.

Revenues

Commissions climbed 22% in the 1Q 1985, accounting for 32% of the rise in proximate non-interest revenues. On the NYSE, AMEX and Regional exchanges, average daily share volume rose 30% to 142.4 million shares in the 1Q 1985 from 111.4 million shares in 1984. Similarly, the dollar value of shares traded increased 30%, to \$296.2 billion in the 1Q 1985 from the quarterly average of \$226.6 billion in 1984.

Trading profits jumped 24% and represented 37% of the increase in proximate non-interest revenues. Profits from market making OTC soared by 63% as OTC prices rose substantially. The NASDAQ Composite Index averaged 280.7 in the 1Q 1985, compared with the 1984 average of 246.9. Trading profits on debt securities increased 18% and were responsible for 21% of the rise in proximate non-interest revenues as interest rates on government bonds declined early in the 1Q 1985 before rising in the latter half of the quarter.

Underwriting revenues increased 3% in the 1Q 1985 as revenues from equities soared by 99% while revenues from debt declined by 6%. Common stock underwriting volume climbed by 90% in the 1Q 1985, but decreases occurred in both corporate debt volume (9%) and municipal volume (15%).^{14/}

Mutual fund sales revenues soared 72% in the 1Q 1985 from the 1984 level. They accounted for 11% of the rise in proximate non-interest revenues. First-quarter sales of mutual funds other than short-term funds were a record \$20.0 billion and consisted of \$18.4 billion of new sales and \$1.6 billion of reinvested dividends.^{15/} Sales of equity funds amounted to \$6.5 billion; combination equity and bond funds, \$6.9 billion; corporate bond funds, \$1.6 billion; municipal bond funds, \$4.0 billion; and option funds, \$1.0 billion.

Net margin interest income appears to have also risen because of the increased interest in equities. Customer average margin debit balances rose 23%, to \$27.7 billion in 1Q 1985 from the \$22.6 billion average in 1984, and average free credit balances increased 15%, to \$17.8 billion in 1Q 1985 from the \$15.5 billion average in 1984.

^{14/} Sources: Dealers' Digest and The Bond Buyer

^{15/} Source: Investment Company Institute

Other-related revenues increased by 11% in the 1Q 1985, compared with a 43% climb in 1984. The average overnight repo rate decreased from 10.1% in 1984 to 8.4% in the 1Q 1985, while the average amount of reverse repos rose 19%, from \$86.9 billion in 1984 to \$103.5 billion in the 1Q 1985.^{16/}

Expenses

Increased attention was apparently paid to controlling costs as non-interest expenses rose only 11%. At least 50% of the 1Q 1985 increase in non-interest expenses resulted from the improvement in agency business. For example, RR compensation rose 18% and accounted for 42% of the rise in non-interest expenses.

Total employment expenses rose by 13% overall, however, so-called fixed expenses increased by only 7%. The rate of increase in communications (5%) and occupancy and equipment (14%) costs slowed significantly while expenditures on EDP equipment fell (8%).

Conclusion

Industry profitability in 1984 was abnormally low and at its lowest level since 1977. Although it will be difficult to duplicate the unprecedented profitability the industry enjoyed for 1979 to 1983, factors are in place for ROE to rise appreciably in 1985. Cost containment programs have been instituted and interest rates have fallen. This improvement was already evident in the 1Q 1985 as the industry's annualized after-tax ROE rose to 16%, compared with 7% in 1984. In addition, profits will be less concentrated among the firm categories in 1985 than 1984 because of the pickup in retail business and rise in equity prices.

^{16/} Data on 1Q 1985 M&A fees and private placement fees are not yet available.

Ira Epstein
Assistant Director
of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	April 1985	YEAR-TO-DATE 1985	April 1985	YEAR-TO-DATE 1985	% CHG. Y-T-D 1985 - 1984
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	94.4	108.5	85.9	93.1	16.5%
AMEX (MILS.)*	7.8	9.0	5.9	6.2	45.2
NASDAQ (MILS.)*	71.7	80.3	57.4	60.3	33.2
REGIONAL EXCHANGE (MILS.)*	15.6	18.8	13.9	14.1	33.3
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	69,670	311,857	56,351	265,354	17.5
AMEX (MILS.)					
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,201	27,576	6,900	29,290	(5.9)
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,311	64,821	13,376	54,751	18.4
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	51.7	51.2	49.6	49.3	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	10,059	47,295	8,793	37,868	24.9
AMEX OPTIONS	2,342	11,473	2,644	12,617	(9.1)
COMMODITY	12,337	52,004	11,652	49,249	5.6

* MONTHLY AVERAGE

YIELDS
(MONTHLY AVERAGES)

	April 1985	April 1984	Basis Point Change April 85-April 84
BOND BUYER INDEX (20 BOND)	9.41	9.96	(55)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.23	12.81	(58)
Baa CORPORATE	13.51	14.31	(80)
RATIO Aaa CORPORATES TO Baa CORPORATES	.91	.90	1
MUNICIPAL BOND YIELD (MOODY'S)	9.42	9.54	(12)

PRICES
(END OF MONTH)

	April 1985	April 1984	% Change April 85-April 84
DOW JONES INDUSTRIALS	1258.06	1170.75	7.46
STANDARD & POOR'S 500	179.83	160.05	12.36
NYSE COMPOSITE	104.12	91.98	13.20
AMEX MARKET VALUE INDEX	227.44	210.40	8.10
VALUE LINE COMPOSITE	191.58	179.91	6.49
NASDAQ COMPOSITE	280.56	247.44	13.39

UNDERWRITING
(DOLLARS IN MILLIONS)

CORPORATE FINANCING
(Gross New Issues)

Total
Common Stock
of Common Stock Issues
Preferred Stock
of Preferred Stock Issues
Corporate Debt
of Corporate Debt Issues

11,132
2,096
63
643
12
8,393
93

5,975
611
48
223
4
4,757
43

86.3%
243.0
31.3
188.3
200.0
76.4
116.3

MUNICIPAL FINANCING
(Gross New Issues)

Total
Notes
Bonds

13,727
4,587
9,140

11,293
6,158
5,135

21.6%
(25.5)
78.0

	April 1985	April 1984	% Change April 1985 - April 84
CORPORATE FINANCING (Gross New Issues)			
Total	11,132	5,975	86.3%
Common Stock	2,096	611	243.0
# of Common Stock Issues	63	48	31.3
Preferred Stock	643	223	188.3
# of Preferred Stock Issues	12	4	200.0
Corporate Debt	8,393	4,757	76.4
# of Corporate Debt Issues	93	43	116.3
MUNICIPAL FINANCING (Gross New Issues)			
Total	13,727	11,293	21.6%
Notes	4,587	6,158	(25.5)
Bonds	9,140	5,135	78.0

MARGIN DEBT OUTSTANDING (\$MILS)
 NET CHANGE IN MARGIN DEBT (\$MILS)
 % OF ACCOUNTS WITH EQUITY UNDER 40%

* ALL TIME HIGH

MARGIN DEBT		
1985 April	1984 April	% Change Apr. 85-Apr. 84
23,900	22,830	4.7
1,070	7,570	(85.9)
11	12	-----

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	First Quarter 1985	Yr.-To-Date 1985	First Quarter 1984	Yr-To-Date 1984	% Change 4th Q.1985 4th Q.1984	Yr.-To-Date % Change 1985 - 1984
<u>REVENUE</u>						
SECURITIES COMMISSION INCOME	\$2,167	\$2,167	\$1,972	\$1,972	9.9%	9.9%
TRADING PROFITS	2,345	2,345	1,947	1,947	20.4	20.4
UNDERWRITING	700	700	553	553	26.6	26.6
<u>TOTAL REVENUE</u>	8,970	8,970	7,944	7,944	12.9	12.9
<u>TOTAL EXPENSES</u>	8,037	8,037	6,947	6,947	15.7	15.7
<u>NET INCOME BEFORE TAXES</u>	933	933	497	3,497	87.7	87.7
<u>PERCENT OF FIRMS SHOWING LOSS</u>	17.1%	17.1%	31.3%	31.3%	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>SOURCE</u>
<u>The New York Securities Industry: Its Contribution To New York State and City</u>	This recent study, conducted by Professor Allan Young of Syracuse University, concludes that the New York securities industry has a significant impact on the State and City economies. For instance, the study finds that the industry contributes directly and indirectly almost 10% of all taxes collected by the City and State. Additionally, one in six private sector jobs was created by the securities industry.	Orders being taken by SIA \$20 Members, \$35 Others
<u>Comparison of Individual Taxation of Capital Gains on Portfolio Stock Investment in Seventeen Countries</u>	SIA/Arthur Andersen study summarizes and discusses major differences in tax treatment of capital gains. Despite major changes, the U.S. tax treatment of capital gains is still generally harsher than that of other countries. Quick reference tables comparing tax rates and holding period in eleven major industrial countries and Pacific Basin.	Publications Department SIA \$10 per copy
<u>Securities Industry 1985-86</u>	Sixth annual edition of vital statistics on over 500 SIA member firms and industry. This 640-page hardcover book includes: rankings of firms, directory of members and industry and market data.	Yearbook Department SIA \$50 Members \$85 Others
<u>1984 NASDAQ FACT BOOK</u>	Statistical review of NASDAQ activity in 1984. Tables include NASDAQ monthly closing index values and average daily sharevolume. Fact Book includes a special section on the performance of NASDAQ securities.	NASD 1735 K Street, N.W. Washington, D.C. 20006
<u>1984 NYSE FACT BOOK</u>	Statistical review of 1984. Tables include market activity data and stock price trends. Fact Book includes historical data from 1970 to 1983, and where available, information prior to that.	New York Stock Exchange, Inc. Eleven Wall Street New York, N.Y. 10005
<u>The Fortune 500</u>	Fortune's annual listing of the 500 largest industrial corporations. Among these corporations, sales increased 4.3% as compared to the prior year, just about even with inflation. Statistical information includes data on sales and assets earning per share.	Fortune 4/29/85

President Reagan's
Tax Proposals to the
Congress for fairness,
growth and simplicity

The President's proposal for reform of the current tax code are detailed in this proposal. Would overhaul current fourteen brackets into three brackets and reduce capital gains to 17.5%. Also proposed are the elimination or curtailment of 65 categories of preferential tax treatment.

BNA Customer Service Center
945 Key West Ave.
Rockville, Md. 20850
\$35 per copy

The State of Small Business
A Report to the President

Comprehensive report on the state of small business in the United States. A detailed statistical section on trends in small business employment is included. Additionally, information is given on the deregulation of small business, small business financing, and women and minority owned businesses.

Superintendent of Documents
U.S. Government Printing Office
Washington, D.C. 20402

"The Worlds Best
Stockbrokers"

A look at the top stock analysts and brokerage firms in the worlds ten largest stockmarkets. The four U.S. brokerage houses selected are Goldman, Sachs, Morgan Stanley, Salomon Brothers and Paine Webber. If you want to know who the top analysts were, read this article. Also included is Euromoney's corporate list of international equities.

Euromoney
May 1985

"The Troubled Market in
Federal Securities"

The recent failures of ESM Government Securities and Bevill, Bresler & Schulman led to discussion and Congressional hearing on regulation of government securities dealers. While the author makes clear that the government securities market is in need of greater attention, he warns against burdensome regulation which could make things worse.

Fortune
5/13/85